

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS BELL TELEPHONE COMPANY)	
)	01-0302
Annual Rate Filing for Noncompetitive Services)	
Under an Alternative Form of Regulation)	

**REPLY BRIEF ON EXCEPTIONS
OF ILLINOIS BELL TELEPHONE COMPANY**

Illinois Bell Telephone Company (“Ameritech Illinois” or the “Company”), by its attorney, hereby replies to the briefs on exceptions filed by the Commission Staff (“Staff”) and the Citizens Utility Board and Illinois Attorney General (“CUB/AG”) in the captioned proceeding.

I. EXOGENOUS CHANGE FACTOR

The Proposal Order properly concludes that deferring the issue of exogenous change treatment for carrier access charge reductions until next year’s annual filing is appropriate. (HEPO, pp. 5-6). This conclusion responds to Staff’s view that deferral would be untimely. Staff does not object to this disposition of the access charge issue. Therefore, the Proposed Order should not be changed, other than to delete the reference to the Proposed Order in the Alternative Regulation Plan review proceeding, as both Ameritech Illinois and Staff have recommended.

CUB/AG’s argument that the Proposed Order encourages repeated litigation is wrong on its facts and should be ignored. CUB/AG’s citations to the Commission’s Order in the access charge reform docket are highly selective and misleading. In that Order, the Commission clearly authorized Ameritech Illinois to seek offsetting rate changes either through its rate rebalancing proposal or thorough a request for exogenous change treatment:

“We do not need to determine whether reducing access rates to LRSIC-based levels will trigger exogenous factor treatment for Ameritech, and we decline to do so at this time. That determination is better left for a later time once the financial impact, if any, of our mandated access charge reductions can be determined....

“We agree with AT&T witness Ms. Conway that this proposal [offsetting Ameritech’s access charge reductions with increases in network access line rates] is better addressed in the context of Ameritech’s rate rebalancing docket (ICC Docket No 98-0335), where Ameritech can update its LRSIC studies....” Phase II Order in Dockets No. 97-0601/0602/0516, adopted March 29, 2000, at pp. 52-53.

Since the Commission explicitly provided Ameritech Illinois with the option to pursue exogenous change treatment in an appropriate proceeding, CUB/AG’s position is unreasonable and should not be adopted. CUB/AG can make whatever arguments they wish if Ameritech Illinois actually requests exogenous treatment in next year’s filing, based on the Commission’s disposition of this issue in the Alternative Regulation Plan review proceeding.¹

II. RESIDENTIAL USAGE DISCOUNTS

Staff proposes certain modifications to the text of the Proposed Order to more accurately reflect its proposal relative to residential usage discounts. (Staff Exc., pp. 5-6). Ameritech Illinois does not object to these changes per se. However, as stated in the Company’s exceptions, the Commission should adopt Ameritech Illinois’ methodology, because it is a fairer interim solution. In the event that Staff’s methodology is used, it should be subject to true-up.

III. NEW SERVICES

Both CUB/AG and Staff continue to argue that new pricing options do not constitute new services. (CUB/AG Exc., pp. 9-11; Staff Exc., pp. 14-16).² They are clearly incorrect. Flat rate ISDN and the “WORKS” package provide customers with pricing options they did not have before. Customers can continue to subscribe to ISDN on a measured rate basis and/or purchase

¹ The Company further notes that it has withdrawn its rate rebalancing proposal in that docket, because of uncertainties resulting from the passage of H.B. 2900.

features out of the tariff at existing tariffed prices if those pricing plans are more advantageous to them. Contrary to the impression conveyed by CUB/AG's Exceptions, there is not a shred of evidence in this record that these services contain "price increases outside the formula".

Obviously, customers will not subscribe to these new options if they conclude that they will not benefit from them.³ CUB/AG is attempting to micromanage Ameritech Illinois' introduction of new services through the back door of the "new service" definition, and, by so doing, effectively deny new pricing options to customers. This is improper and should not be permitted.

In its proposed substitute language, Staff claims that customers that select these pricing options should continue to receive "the protections afforded them under the Alternative Regulation Plan". (Staff. Exc., p. 16). Customers will receive those protections as soon as the initial year has passed and the new services are incorporated into the price index. Staff also describes the lack of market experience as "unconvincing, since customers are currently purchasing such services, albeit in different combinations". (*Id.*) Staff is missing the point. Using flat rate ISDN as an example, the fact that the Company offers ISDN on a measured rate basis does not tell it how many of those ISDN customers will switch to flat rate and/or how many non-ISDN customers will subscribe, now that there is a flat rate option.

In short, the Proposed Order's conclusion on this issue is correct and should not be changed.

IV. SERVICE QUALITY

CUB/AG's exceptions regarding service quality raise no new issues. Most importantly, they do not call into question the central facts that support the finding in the Proposed Order. It

² Both Staff and CUB/AG here withdraw their opposition to extended Intercept Service.

³ The "WORKS" package provides features at a discount. It does not contain price increases. Like any flat rate service, flat rate ISDN will be advantageous for customers who make relatively more ISDN calls and measured

remains clear that Ameritech Illinois has always reported its installation data including vertical service orders and that the calculation of the benchmark in the current Plan therefore also included vertical service orders. CUB/AG's attempts to dance around those facts are unconvincing.

First, CUB/AG contend that they are not trying to change the rules in the middle of the game, because Staff informed Ameritech Illinois that it disagreed with Ameritech Illinois' definition of this measure approximately a year ago. (CUB/AG Exc., p. 12). This is irrelevant. The existing benchmark was set in 1994, not last year. The only relevant question is: What does the existing benchmark include? Clearly, it includes vertical service orders. The fact that Staff announced its intent to change the rules a year ago does not somehow change the way in which the benchmark was calculated in 1994.

Second, CUB/AG contend that "the Company stubbornly continues to include vertical service installation times in the overall calculation of regular service installations." (Id.). That allegation is also irrelevant, as well as being incomplete and misleading. For purposes of the Alternative Regulation Plan, Ameritech Illinois does in fact continue to report its installation data in the same way they have always been reported. In that context, what CUB/AG calls "stubborn" simply means "consistent." However, Ameritech Illinois has also reported its installation data excluding vertical services orders since soon after Staff raised the issue. Thus, Ameritech Illinois has hidden nothing. It has simply reported the data—for purposes of the Plan—in the same way it always has, consistent with the manner in which the benchmark was calculated.

rate ISDN will be advantageous for customers who make relatively fewer. It is impossible to say whether this rate option would represent a rate increase or not -- it depends on the customer.

V. MERGER COSTS AND SAVINGS

Staff and CUB/AG both take exception to the Proposed Order's discussion and conclusions regarding the treatment of merger costs and savings. (Staff Exc., pp. 6-14; CUB/AG Exc., pp. 5-8). For the reasons discussed below, the exceptions of Staff and CUB/AG should be rejected.

Under Ameritech Illinois' calculation, the amount of net merger savings for 2000 which should be passed on to ratepayers pursuant to the Commission's Order in the SBC/Ameritech merger proceeding (Docket 98-0555), is \$2.75 million. In their Comments filed in this proceeding, Staff and CUB/AG made arguments challenging the Company's calculation of merger costs and savings. Staff and CUB/AG each calculated levels of net savings different than the amount calculated by the Company and proposed that the Company be required to flow through such amounts to customers in this proceeding.

The Proposed Order (pp. 12-13) rejects the approach suggested by Staff and CUB. Instead, the Proposed Order follows the same approach adopted by the Commission in the last Annual Rate Filing proceeding, Docket 00-0260. In the Order in that case, the Commission recognized that the process of auditing reported merger costs and savings has proved to be too consuming, and the contested issues too complex, for the expedited annual filing process. The Commission, therefore, established a separate process for addressing merger costs and savings: a separate docket is initiated once the annual audit has been completed and all savings amounts are potentially subject to retroactive true-up, once a final amount has been determined. Order in Docket 00-0260, adopted June 27, 2000, at p. 9. Since that Order, the merger savings audit report for 1999 has been completed and the Commission has initiated a review proceeding in

Docket 01-0128, which allows all parties to examine the audit results and present testimony addressing any contested issues.

Consistent with the approach established in Docket 00-0260, the Proposed Order properly concludes that the proposals made by Staff and CUB/AG with respect to merger costs and savings should be rejected at this time and directs that a contested case proceeding be initiated following completion of the audit of 2000 merger costs and savings. As the Proposed Order (p. 13) indicates, that proceeding will provide the parties with an opportunity to address issues related to the proper calculation of merger costs and savings. The Proposed Order also concludes that a flow through of merger-related savings should not be required at this time pending completion of the annual audit for the year 2000.

Staff and CUB/AG both take exception to the Proposed Order's decision to defer any reduction in rates to reflect 2000 merger costs and savings. (Staff's Exc., p. 8; CUB/AG Exc., pp. 5-6). As the Proposed Order recognizes, however, it would be more efficient from an administrative perspective to defer any credits until a final amount has been determined by the Commission, particularly in light of the relatively small amount of the credit which the Company has identified. Consistent with the Commission's Order in Docket 00-0260, once credits for 2000 are determined, they will be retroactive to July 1 of this year. Therefore, ratepayers will receive all of the benefits to which they are entitled and Ameritech Illinois will not experience any net financial gain from the deferral. Contrary to CUB/AG's unfounded assertion (Exc., p. 6), Ameritech Illinois has no incentive or desire to drag out the audit process simply to defer a flow through of \$2.75 million. In fact, because Ameritech Illinois is required to bear the costs

associated with the third party audit (which, for the audit of 1999 costs and savings, totaled over \$1.2 million), the Company has every incentive to expedite the audit process.⁴

Staff takes the position that data from 1999 should not be included in the filing for 2000 and, based on that position, proposes that a credit of \$3.36342 million (rather than \$2.75 million) be flowed through to customers immediately. (Staff Exc., pp. 8, 13). Staff's position was properly rejected by the Proposed Order. Because the Merger was not consummated until October of 1999, there were only 85 days in 1999 subject to the Commission's merger savings requirements. Accordingly, the upfront costs incurred in 1999 to produce annual savings were offset by only 85 days (rather than 365 days) of savings, resulting in net merger costs (rather than net savings) for that 85 day period. It is, therefore, appropriate to view 1999 and 2000 as a single reporting year. In this regard, Staff's contention that the 1999 merger costs (which produced savings in 2000) should be disregarded appears to be inconsistent with its statement elsewhere that costs "should be deferred until such time as they produce savings." (Staff Exc., p. 7). Moreover, the outside accounting firm retained by the Commission to audit merger costs and savings in accordance with the Merger Order (BWG) recommended in its audit report on year 1999 that 1999 costs and savings information be combined with year 2000 information in the year 2000 report to ensure that there is an "appropriate matching of costs and savings and that costs are not double counted". SBC/Ameritech Merger Investigation For the Illinois Commerce Commission, Final Report, Barrington-Wellesley Group, Inc., January 8, 2001, at p. VII-43. Therefore, this issue should be considered in the audit review proceeding (Docket 01-0128).

⁴ CUB/AG's assertion that "the review of the 1999 data has been delayed by IBT's refusal to pay the auditor's litigation expenses" is completely unwarranted. The current "delay" in review of the audit of 1999 merger costs and savings is a direct result of the Commission's decision to grant Staff's request for a stay of Docket 01-0128 pending a resolution in Docket 00-0260 (reopening) of the issue of whether the Commission or Ameritech Illinois is responsible for bearing the costs of the auditor's participation in Docket 01-0128. The Company has never sought to delay the review of its 1999 costs and savings and does not believe that the stay requested by Staff was necessary (although the Company did not object to the stay).

Staff also asserts that the Proposed Order does not accurately recount Staff's positions on certain issues related to merger costs and savings. The Company disagrees and believes that the Proposed Order does a good job of summarizing Staff's positions as those positions were expressed by Staff in its Comments.⁵ Staff also takes the opportunity to clarify its position regarding the appropriate treatment of costs that do not produce net savings in the year the costs are incurred, by stating that "Staff has not proposed a permanent disallowance of these costs, but believes that they should be deferred." It is not clear, however, how this statement squares with Staff's assertion, at page 8 of its Exceptions, that "each year's annual price filing should reflect only data related to the current year." This lack of clarity, and the apparent shifts in Staff's positions from its Comments to its Exceptions, serves to underscore the need to affirm the Proposed Order's decision to defer litigation of issues related to merger costs and savings.

In its Exceptions (pp. 7-8), CUB/AG continue to argue that costs associated with savings initiatives should be amortized over ten years and that a credit calculated on that basis should be ordered in this docket. CUB/AG (Exc., p. 8) argue that amortization is necessary to ensure that costs are not "front loaded on to bills for non-competitive services." As the Proposed Order properly recognizes, this issue (like the issues raised by Staff) has no place in this proceeding. Absolutely nothing in the Commission's Merger Order requires amortization. In fact, by insisting that merger savings be based on actual data, and that they be flowed through on a calendar year-by-calendar year basis, the Commission's Order clearly supports the Company's approach, which nets all merger costs and savings actually incurred in each calendar year.

⁵ For example, Staff takes issue with (i) the Proposed Order's statement that "Staff recommended that IBT be ordered to develop a revised shared and common cost study and file revised UNE tariffs" and (ii) the Proposed Order's summary of the Company's response to that recommendation. (Staff Exc., pp. 7, 12-13). The Proposed Order's statement, however, accurately recites the argument made by Staff at page 24 of its Initial Comments. Contrary to Staff's assertion (Exc., p. 7), Ameritech Illinois' response comments, as summarized in the Proposed Order, are relevant because they are directly responsive to Staff's comments.

CUB/AG argue that their position is somehow supported by recent legislation affecting the competitive classification of business services. This argument does not make sense. The annual credits for merger costs and savings required by the Merger Order are allocable to end users of both competitive and non-competitive services on a per network access line basis. (Order, Docket 98-0555, p. 150). Accordingly, there is no logical basis for CUB/AG's argument (Exc., p. 8) that "costs associated with the merger will be unfairly borne by services classified as noncompetitive."

To the extent that the Commission wishes to consider the amortization proposal further, it should be deferred to the audit proceeding where a full record can be developed to address issues concerning the proposal. For example, CUB/AG does not provide a basis for a 10-year amortization period. Contrary to CUB/AG's representation (Exc., p. 7), their position is not consistent with the positions taken by Ameritech Illinois and Staff in Docket 98-0555. In that case, the Company presented a net present value analysis of estimated merger savings and costs over the first three-year period following merger consummation and suggested that it be the maximum amount flowed through to ratepayers in the event that the Commission made its decision based on estimates. Similarly, Staff made it clear that its 10-year amortization proposal applied only "if a net present value calculation is done". Order in Docket 98-0555, supra, at p. 143. Since the Commission did not adopt a net present value approach, Staff's proposal in Docket 98-0555 has no bearing on this proceeding.

Furthermore, CUB/AG's approach does not result in netting against merger savings the full amount of the costs incurred to produce those savings. When a cost is recovered over an amortization period, the utility has an investment during the amortization period in the unamortized balance of the cost. The Illinois Supreme Court has held that allowance of a

recovery of the capital costs associated with the investment in the unamortized balance is necessary to provide full cost recovery. Citizens Utility Board v. Commerce Comm'n., 166 Ill. 2d 111, 124-125 (1995). CUB/AG does not propose to include an allowance for the capital costs associated with the unamortized balance of the merger costs which it proposes to amortize over ten years. Adoption of the CUB/AG approach would, therefore, result in a sharing with customers of more than 50% of the net merger savings, in contravention of the Merger Order.

VI. CONCLUSION

For the reasons discussed, the Exceptions of Staff and CUB/AG to the Proposed Order should be rejected.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Karl B. Anderson, an attorney, certify that a copy of the foregoing **REPLY BRIEF ON EXCEPTIONS OF ILLINOIS BELL TELEPHONE COMPANY** was served on the parties on the attached service list by overnight delivery and electronic transmission on June 14, 2001.

Karl B. Anderson

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